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Trends in Cuban Foreign Exchange Reserves and Their Effect on Cuba's Credit Position

1. The Cuban government is clearly alarmed by its current foreign exchange situation. In late spring or early summer, high Cuban officials evidently realized that heavy, and often indiscriminate, buying in Free World countries was placing foreign currency reserves under heavy strain. It also became obvious to them that the sharp decline in world sugar prices during 1964 was posing a further serious threat to Cuba's foreign exchange position. Accordingly, the regime has undertaken several moves designed to protect reserves from excessive decline. The Minister of Foreign Trade was replaced in July and the whole purchasing program in Free World areas was placed under critical review. Since about mid-July, Cuban buying in Free World countries has been sharply reduced.

2. These efforts apparently have not succeeded. At the beginning of 1964, Cuban holdings of Free World currencies approached $100 million, [redacted] 25X1 25X1 By the end of September, reserves are estimated to have fallen to about $60 million. [redacted] 25X1 25X1 It is likely that this trend will continue for the rest of 1964, since there is a normal seasonal decline in reserves toward the end of the year.

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3. In all probability, Cuba's reserve position will deteriorate further in 1965. Futures quotations prevailing in the world sugar markets over the past month or more indicate that prices for Cuban sugar exports to the Free World during 1965 will be less than half the average price received for exports this year. It seems unlikely that Cuba will compensate for lower prices by increasing the volume of sugar exports to the Free World in 1965. During recent years, Cuba's sugar exports to non-Communist areas have remained fairly stable at about 1.5 million tons even though both world prices and Cuban production have fluctuated considerably during the period. Any additional sugar Cuba may have to export next year probably will be shipped to the USSR since Castro will be under continuing pressure to reduce his heavy trade deficit with the Soviet Union. Perhaps most importantly, if Cuba were to substantially increase Free World sales, the impact of the additional supply on the world market probably would reduce prices still further.

4. The decline in exchange reserves, particularly convertible currency reserves, has significant implications for Cuba's Free World creditors. With reserves reduced to very low levels, Cuba will be highly vulnerable to the fluctuations which characterize the world sugar market. Faced with any future emergency due to further declines in world sugar prices, Cuba will be forced quickly to reduce hard currency expenditures. Clearly, debt repayments would be one of the easiest and probably one of the first cuts to be made. Fidel Castro has sought to reassure Western creditors by declaring that Cuba will meet its debt payments in spite of the scarcity of foreign exchange. The current reduction in imports

probably will enable Cuba to maintain this policy for the time being. The fact remains, however, that slender reserves will leave Cuba with little room to maneuver in the event of a future substantial drop in export income.

5. Given the present prospects for Cuba's next sugar crop and the price outlook, total export income in 1965 could decline by $100 million or more. Imports will have to be cut by something approaching this figure unless the level of Communist aid is substantially increased. We do not believe it likely that the level of Cuban economic activity will suffer proportionately, however. The 1963-64 rate of capital goods imports has been higher than the Cuban economy can absorb effectively. Her present level of managerial and technical skills are inadequate to the task. In recent years, much of the machinery and equipment arriving in Cuba from Communist countries has accumulated in unused inventory, awaiting the construction of new plant facilities. The capital goods component of imports, which accounts for about 30-35 percent of the total, could probably be cut substantially without serious impact on the current level of economic activity. In 1960, when Cuba was confronted with the necessity of cutting back sharply on imports, it was in fact the capital goods component that bore the brunt of the reduction.

6. Although a judicious paring of imports could mitigate the impact of reduced foreign exchange earnings, some adverse results are likely to follow in any event. Since the loss in export income is to be concentrated on the Free World income component, there probably will be

a loss in high quality imports of certain raw materials and spare parts needed to sustain current industrial production levels. Consequently, the Cuban economy, which now is operating below pre-revolutionary levels and is stagnating, may face further deterioration.

7. The present adjustments will tend to extract much of the waste from the current import pattern. Therefore, if future emergency import cutbacks are forced upon Cuba, they will be considerably more painful and difficult than those now being made. Under these circumstances, it seems likely that the temptation to seek stretch-outs or even to default on debt payments would be more than Cuba could withstand.